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INTELLIGENCE BRIEF

BRAZILIAN INDUSTRIAL RECESSION
DURING THE FIRST QUARTER OF 1965

DIRECTORATE OF INTELLIGENCE
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BRAZILIAN INDUSTRIAL RECESSION
DURING THE FIRST QUARTER OF 1965

The persistent character of Brazil's economic problems was clearly reflected in the first quarter of this year by a rapid rise in unemployment and a decline in industrial production. Having moderated inflationary pressures and undertaken a number of basic economic reforms, the government now faces a stern test of its willingness to sustain counter-inflationary programs in the face of declining industrial activity. The business community is inclined to blame current difficulties on the government's restrictive credit policy; however, a sharp drop in consumer expenditures, particularly for durables, seems the more likely trigger for this decline. The consumer, under pressure from rising prices for previously subsidized goods and services, may be deferring purchases of high-price durables until it is clear whether the regime can deliver on its promises to reduce the rate of inflation. Price resistance by consumers suggests that the government may be slowly gaining support for its counter-inflationary program. Should the government be able to win support from the business community to restrain price increases, President Branco and his financial advisers will have taken a significant step on the road to Brazil's economic recovery.

1. Recession

The slackening of the tempo of industrial activity during the first quarter of 1965 indicates that Brazil is undergoing a mild recession. As the Castello Branco government marked the first anniversary of its accession to power on 31 March, the principal industrial center of the country -- Sao Paulo -- reported retrenchment of production schedules, an increasing number of firms in financial difficulties, some signs of unemployment, and excess inventories of consumer durables. Most seriously affected by the downturn are the automobile and textile industries, but production declines also were reported in automobile parts, home appliances, plastic products, paints, glass, footwear, and furniture.

Several industrial sectors, however, continue to report favorable business conditions. Food processing and machine tool firms have not been adversely affected, and Brazil's largest steel producer, the government-owned Companhia Siderurgica Nacional, reported higher than normal monthly output in March. Furthermore, within the generally depressed motor vehicle industry, Volkswagen, the principal

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C-O-N-F-I-D-E-N-T-I-A-L

manufacturer among Brazil's 11 automotive concerns, reported a new production record of 7,002 units in March.

2. Unemployment

Although Brazilian statistics on unemployment are virtually non-existent, unofficial data for the city of Sao Paulo may serve as an indicator of the general trend of employment in industry. In a survey conducted by an industrial trade association, unemployment in the city was estimated to be about 3,500 people in January, 2,750 in February, and 56,000 in March. The unemployment levels for January and February are considered to be normal, but the number of unemployed in March, which amounts to approximately 8.5 percent of the city's labor force, is not normal.

3. Downturn in the Motor Vehicle Industry

Most seriously affected by the downturn is the motor vehicle industry. In March, automobile manufacturers reported sales of passenger cars to be 20 to 35 percent below the levels of November and December 1964. At least three major producers -- Ford, General Motors, and Willys Overland -- closed down their plants for periods of 1 to 2 weeks, placing the work force on vacation in advance of the time normally scheduled. Layoffs of administrative and production-line personnel in the industry totaled about 5,500 people by 7 March (about 12 percent of the industry's labor force), and additional layoffs were scheduled for the beginning of April. With finished inventories of trucks and passenger cars accumulating at factory and retail levels, manufacturers are reducing procurement orders for parts, components, and materials, with the consequence that unemployment in this industry is on the rise. One industry official expected unemployment in the automobile parts plants to total about 10,000 people by the end of March.

Officials of the motor vehicle industry attribute their difficulties to any number of causes, but one factor -- consumer resistance to the high prices of motor vehicles -- receives particular emphasis. In fact, consumer resistance to high-priced durables in general has been increasing since the turn of the year. One manufacturer of refrigerators reported that stocks totaled about 12,000 units at the end of March and that sales were running at 1,500 units per month

C-O-N-F-I-D-E-N-T-I-A-L

compared with monthly sales of 4,000 units in November-December 1964. In an effort to liquidate excessive inventories of consumer durables, appliance dealers in Sao Paulo and Rio de Janeiro initiated a series of price reductions during March for such items as television sets, sewing machines, refrigerators, and washing machines.

4. Credit Restrictions

Elements of the Brazilian business community blame the current economic downturn on the government's restrictive credit policy which has been in force since the last quarter of 1964 and which is an essential element of the regime's financial stabilization plan. The continued application of this policy in the first quarter of 1965 has been accompanied by an increase in the number of business failures. In February 1965, bankruptcy petitions in Sao Paulo totaled 161 compared with 126 petitions in January 1965 -- an increase of 28 percent (68 percent above the 96 petitions entered in February 1964). Significantly, the majority of business failures have been restricted to small firms. In general, these firms were marginal enterprises, depending on speculation and abnormal credit facilities for their survival. Undoubtedly the restriction of credit by financial authorities is an important factor in explaining the relatively high level of business failures since the beginning of 1965. Nevertheless, the downturn in business activity is due more to a sharp decline in consumer demand, notably for consumer durables, than to the government's tight credit policy. The response of consumers to price cuts for durables is reported to be favorable and seems to indicate that buyers have been delaying purchases and waiting for lower prices.

5. Campaign to Restrain Price Increases

The government is optimistic that consumer-induced price cuts presage a change from pricing practices prevailing on the part of manufacturers and retailers and a reversal of the inflationary mentality of the Brazilian public. Conditioned to inflation as a way of life, businessmen are addicted to price markups that cover not only past increases in costs but also expectations of future increases as well. Heretofore, consumers willingly absorbed the markups because of their outlook of "buy today because prices will be higher tomorrow." In the public's view, purchases of consumer durables constituted a hedge against the steadily depreciating value of the cruzeiro.

Beginning in February 1965, the regime initiated a vigorous campaign to counteract the inflationary mentality of the Brazilian

C-O-N-F-I-D-E-N-T-I-A-L

public in general and of the business community in particular. The administration, in the person of President Branco and his leading financial advisers, delivered a series of addresses before business and trade organizations warning the business community that the practice of anticipatory price increases must cease. As an inducement for business firms to limit price increases during the remainder of 1965, the Branco government is preparing to grant financial benefits to enterprises adhering to the regime's price restraint program. To firms agreeing to maintain prices prevailing at the end of January 1965 or receiving prior government authorization to increase prices on the basis of proven increases in costs, the government will allow tax benefits (subject to Congressional approval) and certain monetary advantages. Included in the latter category, and having an immediate impact on a firm's daily operations, will be an increase in the weekly limit on purchases of foreign exchange for imports, greater access to credit facilities from the Bank of Brazil, and an exemption from the 10-percent surcharge on purchases of exchange for imports and from compulsory advance deposits for exchange to cover merchandise imports.

6. Business Reaction

The initial reaction to the government's fiscal-monetary incentives has been mixed. Industrialists in Sao Paulo are reported to be skeptical of the government's ability to administer the price restraint program. They contend that the difficulties of enforcement in many sectors of industry together with inadequate staffs of government agencies will make the program unworkable. Despite these misgivings, an increasing number of firms are entering into agreements with the Superintendency of National Supplies, the federal agency that will police the program. These businessmen apparently believe that only through adherence to the regime's price restraint program will they have access to the bank credit they need to finance commercial activity.

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